

## Message Text

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TO ALL DIPLOMATIC POSTS

XMT USLO PEKING

C O N F I D E N T I A L STATE 188024

E.O. 11652: GDS

TAGS: ENRG

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SUBJECT: CIEC; PROTECTION OF PURCHASING POWER OF COMMODITY  
EXPORTS EARNINGS OF DEVELOPING COUNTRIES AND TREATMENT  
OF OPEC ASSETS; US POSITION IN CIEC

REF: 1) STATE 182691; 2) STATE 184169

1. THIS MESSAGE COVERS THE US POSITION ON THE PROTECTION OF PURCHASING POWER OF COMMODITY EXPORT EARNINGS INCLUDING OIL EXPORT EARNINGS (INDEXATION) AND ON PROTECTION OF ACCUMULATED OPEC FINANCIAL SURPLUSES. THIS IS ONE OF THE TWO ISSUES ON WHICH DEVELOPING COUNTRY PARTICIPANTS IN CIEC (G-19) DEMANDED PREJUDICIAL LANGUAGE IN THE WORK PROGRAMS OF THE ENERGY AND RAW MATERIALS COMMISSIONS FOR THE SECOND HALF OF CIEC. (SEE REFTEL 1 FOR REPORT COVERING THE FAILURE OF THE COMMISSIONS IN THEIR JULY SESSIONS TO REACH AGREEMENT ON THE WORK PROGRAMS.) THE OTHER ISSUE ON WHICH THE G-19 DEMANDED PREJUDICIAL LANGUAGE IS GENERALIZED DEBT RELIEF FOR DEVELOPING COUNTRIES. (SEE REFTEL 2 FOR US POSITION ON THIS ISSUE.)

2. THE US DOES NOT BELIEVE THAT PRESENTLY AVAILABLE EVIDENCE SUPPORTS THE VIEW THAT THE PURCHASING POWER OF LDC EXPORT EARNINGS HAS SERIOUSLY ERODED OVER TIME. MOREOVER, WE HAVE FUNDAMENTAL ECONOMIC AND TECHNICAL PROBLEMS WITH INDEXATION, WHICH IS THE ONLY CONCEPT OFFERED BY DEVELOPING COUNTRIES TO DEAL WITH THIS ALLEGED EROSION. HOWEVER, WE RECOGNIZE THE IMPORTANCE OF EXPORT EARNINGS IN THE DEVELOPMENT PROCESS AND DO NOT DENY THAT PURCHASING POWER OF EXPORT EARNINGS IS A LEGITIMATE TOPIC FOR DISCUSSION IN CIEC. WE WOULD BE WILLING TO DISCUSS IT UNDER ANY NEUTRAL FORMULATION WHICH DOES NOT PREJUDGE THE OUTCOME OF THE DISCUSSION. WE ARE PREPARED ALSO TO ACCEPT AND DISCUSS IN CIEC THE CONCERNS OF THE OIL EXPORTERS WITH REGARD TO FAIR TREATMENT OF THEIR INVESTED FINANCIAL SURPLUSES JUST AS WE SEEK SUCH TREATMENT FOR OUR OWN INVESTMENTS ABROAD. HOWEVER, THE CASE FOR SPECIAL TREATMENT OF THEIR FINANCIAL ASSETS IS NOT CONVINCING.

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3. IT IS NOT CLEAR TO US THAT THE G-19 POSITION OF INDEXATION IS FIRMLY FIXED, OR WHETHER THE G-19 PRESSED INDEXATION TO PREVENT THE DEBT RELIEF QUESTION FROM BEING THE ONLY ISSUE ON WHICH AN AGREED WORK PROGRAM FORMULATION COULD NOT BE ACHIEVED. THE INDEXATION

ISSUE HAS BEEN DISCUSSED IN THE ENERGY, RAW MATERIALS, AND FINANCIAL AFFAIRS COMMISSIONS, BUT THE MAIN G-19 EFFORTS ON THE ISSUE HAVE BEEN IN THE ENERGY COMMISSION. IN THIS COMMISSION, THE G-19 HAS ALWAYS COUCHED THE ISSUE IN TERMS OF GENERAL PROTECTION OF PURCHASING POWER OF THE EXPORT EARNINGS OF LDC'S AS A WHOLE, BUT THEIR ARGUMENTATION AND EVIDENCE HAS BEEN ALMOST

COMPLETELY CONCENTRATED ON INDEXATION OF THE OIL PRICE. THE OPEC MEMBERS OF THE G-19, PARTICULARLY ALGERIA, IRAN, AND IRAQ HAVE STRONGLY PUSHED THE CONCEPT IN ENERGY COMMISSION, RECEIVING ONLY NOMINAL SUPPORT FROM NON-OIL LDC MEMBERS OF THAT COMMISSION. ON THE ISSUE OF OIL PRICE INDEXATION PER SE, AS CONTRASTED WITH PROTECTION OF OPEC FINANCIAL SURPLUSES, THE ATTITUDE OF SAUDI ARABIA HAS ALSO APPEARED LUKEWARM.

4. US STATEMENTS ON PROTECTION OF PURCHASING POWER HAVE BEEN PRESENTED IN THE ENERGY AND FINANCIAL AFFAIRS COMMISSIONS, AND WERE MADE AVAILABLE TO ALL PARTICIPANTS. THE US TABLED A PAPER ON THE SUBJECT IN THE RAW MATERIALS COMMISSION. THE FOLLOWING IS BASED ON THOSE STATEMENTS AND THE PAPER. POSTS SHOULD DRAW UPON THIS AT THEIR DISCRETION IN DISCUSSING THE INDEXATION ISSUE IN CIEC WITH APPROPRIATE HOST GOVERNMENT OFFICIALS. PRICE INDEXATION OF COMMODITIES

5. THE MAJOR DIFFICULTIES WITH INDEXATION ARE ECONOMIC. THE INDEXATION OF THE PRICE OF A COMMODITY TIES THE PRICE OF THAT COMMODITY TO THE PRICE OF SOME GROUP OF OTHER GOODS. ASIDE FROM THE PROBLEM OF DETERMINING A PROPER GROUP OF GOODS AND ESTABLISHING BASE PERIOD PRICES, INDEXATION OF A COMMODITY WOULD RESULT IN A PRICE LEVEL DIFFERENT FROM THAT WHICH WOULD PREVAIL IF MARKETS WERE LEFT TO DETERMINE THEIR OWN EQUILIBRIUM. A PRICE EITHER ABOVE OR BELOW MARKET LEVELS WOULD BE DELETERIOUS TO THE WORLD ECONOMY. (GIVENTHATDEVELOPING COUNTRIES DESIRE TO CONFIDENTIAL

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STABILIZE AND INCREASE EXPORT REVENUES, IT APPEARS THAT THEY WOULD ONLY AGREE TO AN INDEXATION SCHEME WHICH THEY BELIEVE WOULD SET PRICES AT LEVELS HIGHER THAN MARKET FORCES WOULD WARRANT.) WHERE INDEXATION LEADS TO A PRICE THAT IS BELOW EQUILIBRIUM, DEMAND WILL EXCEED SUPPLY AND SHORTAGES WILL RESULT. THESE SHORTAGES WILL UNDERMINE THE SYSTEM. WHEN INDEXATION HOLDS PRICES ABOVE MARKET EQUILIBRIUM LEVELS IT PRODUCES DISTORTIONS IN OTHER MARKETS. THE PRIMARY DISTORTIONS ARE INVESTMENT (PRODUCING COUNTRIES OVERINVEST IN CAPACITY TO PRODUCE THE INDEXED COMMODITY WHILE CONSUMING COUNTRIES MAKE INVESTMENTS IN OTHERWISE UNECONOMIC PROCESSES TO

REDUCE USAGE OF THE INDEXED PRODUCT), CONSUMPTION (CONSUMERS ARE FORCED TO SPEND MORE THAN THEY SHOULD FOR A PRODUCT AND HENCE HAVE LESS TO SPEND ON OTHER PRODUCTS), AND PRODUCTION (SOME ACTIVITIES WHICH WOULD OTHERWISE BE ABLE TO CONTINUE ARE FORCED TO SHUT DOWN).

6. AT PRICES HIGHER THAN OTHERWISE WOULD HAVE OCCURRED, INDEXATION COULD INDUCE THE MORE RAPID DEVELOPMENT OF SUBSTITUTES. IN ADDITION, IT COULD PROVIDE INCREASED

PROFIT INCENTIVES FOR EXISTING PRODUCERS TO EXPAND PRODUCTION AND FOR NEW PRODUCERS TO ENTER THE MARKET. BOTH OF THESE WOULD WORK TO THE LONG-RUN DETRIMENT OF PRODUCING COUNTRIES.

7. INDEXATION WHICH FIXES COMMODITY PRICES ABOVE THEIR MARKET LEVELS WILL TEND TO HAMPER THE DEVELOPMENT PROCESS IN COUNTRIES WHICH IMPORT THE COMMODITIES. BECAUSE A COMMODITY'S PRICE IS HIGHER THAN IT OTHERWISE MIGHT BE, PRODUCTS MADE FROM THAT COMMODITY WILL COST MORE. THE LEVEL OF INFLATION IN CONSUMING COUNTRIES WILL BE INCREASED. THIS INFLATIONARY EFFECT HAS SEVERAL UNDESIRABLE SIDE EFFECTS. IT LEADS TO FURTHER INCREASES IN THE PRICE OF THE INDEXED PRODUCT (HENCE PERPETUATING THE PRICE INCREASE). IT MAY ALSO INCREASE BALANCE OF PAYMENT DEFICITS IN IMPORTING COUNTRIES. TO THE EXTENT THAT INCREASED INFLATION LOWERS THE RATE OF ECONOMIC GROWTH, INDEXATION ADVERSELY AFFECTS THE ECONOMIC WELFARE IN CONSUMING COUNTRIES. ALSO, TO THE CONFIDENTIAL

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EXTENT THAT LOWER RATES OF ECONOMIC GROWTH REDUCE DEMANDS BY DEVELOPED COUNTRIES FOR OTHER GOODS EXPORTED BY DEVELOPING COUNTRIES, THEY WILL FIND THEIR MARKETS FOR UNAFFECTED PRODUCTS CURTAILED. THESE COUNTRIES WOULD ALSO SUFFER FROM THE HIGHER RATE OF WORLD-WIDE INFLATION.

8. INDEXATION OF COMMODITY PRICES WOULD CAUSE FURTHER INEQUALITIES BY PROMOTING TRANSFER OF RESOURCES FROM DEVELOPING COUNTRY CONSUMERS AS WELL AS INDUSTRIALIZED COUNTRY CONSUMERS WHO WOULD PAY HIGHER PRICES TO PRODUCERS WHO MIGHT BE DEVELOPED OR DEVELOPING COUNTRIES. IN THE CASE OF DEVELOPING IMPORTING COUNTRIES, THE DEVELOPMENT PROCESS IS SLOWED BY LARGER BALANCE PAYMENT DEFICITS AS WELL AS BY THE RISK OF SMALLER MARKETS FOR THEIR OWN GOODS DUE TO LOWER RATES OF WORLD-WIDE ECONOMIC GROWTH. IN THE CASE OF DEVELOPING EXPORTING COUNTRIES DEVELOPMENT IS HAMPERED BY THE OVERINVESTMENT ENCOURAGED BY HIGH PRICES. AS A RESULT, ECONOMIC DIVERSIFICATION MAY NOT

PROCEED AS RAPIDLY AS IT SHOULD THEREBY MAKING THE COUNTRY MORE VULNERABLE TO FUTURE COLLAPSES IN THE MARKET FOR THE INDEXED COMMODITY.

9. INDEXATION OF THE OIL PRICE - INDEXATION OF THE OIL PRICE BY ITSELF IS SUBJECT TO THE ABOVE ECONOMIC OBJECTIONS. BECAUSE OF THE RELATIVE IMPORTANCE OF OIL IN THE WORLD TRADE IT WOULD ALSO POSE SIGNIFICANT INFLATIONARY THREAT TO THE WORLD ECONOMY. THE OIL PRICE INCREASES OF 1973-74 HAD A SIGNIFICANT IMPACT ON INDUSTRIAL COUNTRY PRICE LEVELS. A RIGID LINK

BETWEEN THE OIL PRICE AND THE PRICES OF INDUSTRIAL COUNTRY MANUFACTURED GOODS WOULD TEND TO ACCELERATE THE INFLATIONARY IMPACT OF ANY GIVEN PRICE INCREASE, PARTICULARLY IN INDUSTRIAL COUNTRIES THAT ARE HEAVILY DEPENDENT ON OIL. THESE COUNTRIES MAY HAVE TO ADOPT RESTRICTIVE POLICIES TO COPE WITH THESE INFLATIONARY PRESSURES, THEREBY SLOWING THEIR GROWTH. SUCH ACTION WOULD INDIRECTLY SLOW THE GROWTH RATE IN DEVELOPING COUNTRIES.

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COUNTRIES (INCLUDING OIL PRODUCERS) BY RESTRICTING THE EXPANSION OF THEIR MAJOR MARKETS. SINCE NON-OIL DEVELOPING COUNTRIES ARE SIGNIFICANT IMPORTERS OF OIL AS WELL AS INDUSTRIAL COUNTRY MANUFACTURED GOODS, THEY WOULD ALSO BE DIRECTLY AFFECTED BY OIL PRICE INDEXATION.

10. INDEXATION RATIONALE - THE MAJOR RATIONALE PUT FORWARD BY THE G-19 FOR INDEXATION IS THE CONTENTION THAT THE "TERMS OF TRADE" OF DEVELOPING COUNTRIES HAVE DETERIORATED VIS-A-VIS THE INDUSTRIAL COUNTRIES. (TERMS OF TRADE ARE MEASURED SEVERAL WAYS, BUT THE MOST COMMON IS A RATIO OF EXPORT AND IMPORT PRICE INDICES OF COUNTRIES; THIS IS USUALLY REFERRED TO AS THE "COMMODITY" OR "NET BARTER" TERMS OF TRADE.) THE US QUESTIONS THE RELEVANCE OF TERMS OF TRADE AS A MEASURE OF LDC DEVELOPMENT AND FURTHERMORE DOES NOT ACCEPT THAT THE OVERALL TERMS OF TRADE OF DEVELOPING COUNTRIES HAVE, IN FACT, DETERIORATED. THIS IS PARTICULARLY TRUE FOR THE TERMS OF TRADE OF OIL EXPORTING COUNTRIES. THE EVIDENCE IS AMBIGUOUS, AT BEST, AND DEPENDS CRITICALLY ON METHODOLOGY USED IN CONSTRUCTING TERMS OF TRADE, PARTICULARLY SELECTION OF THE BASE YEAR AND THE LENGTH OF THE TIME SERIES. IF A BASE YEAR IS CHOSEN IN WHICH COMMODITY PRICES WERE AT A CYCLICAL PEAK RELATIVE TO OTHER PRICES, SUCH AS 1952, OR 1958 FOR OIL PRICES, DETERIORATION CAN BE SHOWN. A BASE YEAR AT THE TROUGH OF A CYCLE SUCH AS 1960 OR 1971 WOULD NORMALLY SHOW TERMS OF TRADE IMPROVEMENT. IT IS POSSIBLE

THAT A FEW DEVELOPING COUNTRIES HAVE EXPERIENCED TERMS OF TRADE DECLINE UNDER ANY MEASURING METHODOLOGY BUT THIS IS NOT SUFFICIENT REASON FOR AGREEING TO A UNIVERSAL SYSTEM OF INDEXATION. BY ANY STANDARD, THE TERMS OF TRADE OF OPEC HAVE SIGNIFICANTLY INCREASED IF 1973 AND 1974 ARE INCLUDED.

11. AN UNCTAD EXPERTS WORKING GROUP MEETING IN 1975 USING DATA PROVIDED BY THE UNCTAD SECRETARIAT FOUND THAT IT WAS IMPOSSIBLE TO DETERMINE FROM THE AVAILABLE DATA WHETHER THERE HAS BEEN A DETERIORATION IN LDC COMMODITY TERMS OF TRADE FROM THE BEGINNING

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OF THIS CENTURY THROUGH 1975, THOUGH THERE IS EVIDENCE OF FLUCTUATIONS, OVER TIME. WE DO NOT DISPUTE THAT STABLE AND GROWING OVERALL EXPORT EARNINGS ARE IMPORTANT TO THE DEVELOPMENT PROCESS. BUT STABILITY IS A SHORT-TERM QUESTION. THE US HAS STRONGLY SUPPORTED INTERNATIONAL EFFORTS TO REDUCE THE IMPACT OF FLUCTUATIONS IN EXPORT EARNINGS OF DEVELOPING COUNTRIES WHICH ARE BEYOND THEIR OWN CONTROL THROUGH SUCH MEASURES AS THE RECENT JAMAICA AGREEMENTS OF THE INTERNATIONAL MONETARY FUND TO EXPAND BOTH COMPENSATORY FINANCE FACILITY AND ACCESS TO REGULAR IMF RESOURCES FOR DEVELOPING COUNTRIES. WE HAVE ALSO PROPOSED INTERNATIONAL EXAMINATION OF SUPPLEMENTARY MEASURES WHICH WOULD ALSO PROVIDE PROTECTION FROM FLUCTUATION IN EXPORT EARNINGS.

12. THE IMPORTANT LONG-RUN ISSUE FOR DEVELOPING COUNTRIES IS THE GROWTH OF OVERALL EXPORT REVENUES OVER TIME. SUCH REVENUES SHOULD INCREASE IN ORDER FOR DEVELOPING COUNTRIES TO FINANCE AN EXPANDING QUANTITY OF GOODS OF INCREASING SOPHISTICATION TO MEET THE NEEDS OF GROWING AND DEEPENING DEVELOPMENT PROGRAMS AS WELL AS CHANGING CONSUMPTION PATTERNS. INDEXATION WOULD MASK THE REAL UNDERLYING FORCES WHICH DETERMINE THE OVERALL GROWTH OF EXPORT REVENUES OVER THE LONG TERM, AND THROUGH ITS ADVERSE ECONOMIC EFFECTS NOTED ABOVE WOULD PROBABLY REDUCE THE GROWTH RATE OF SUCH REVENUES.

13. IN PUSHING FOR OIL PRICE INDEXATION OPEC HAS CITED INCREASES IN THE COSTS OF THEIR IMPORTS IN 1974 AND 1975 OF 40 TO 60 (UP TO 100 IN ONE COUNTRY). HOWEVER, US AND OECD EXPORT PRICE MEASURES INDICATE A MUCH LOWER RATE OF PRICE INCREASE FOR EXPORTS TO

OPEC OVER THE SAME TIME FRAME. (THE BULK OF OPEC IMPORTS ARE GOODS EXPORTED BY OECD COUNTRIES). THE UNIT VALUE IMPORT PRICE TRENDS CITED BY OPEC RESULT LARGELY FROM DOMESTIC FACTORS IN THOSE COUNTRIES DUE TO THE RAPID RISE IN THEIR INCOMES, RATHER THAN FROM INTRINSIC INFLATION IN EXPORTING COUNTRIES. OPEC COUNTRIES HAVE SERIOUSLY UPGRADED THE QUALITY OF THEIR  
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PURCHASES PAYING HIGHER PRICES (NOT REFLECTED IN UNIT VALUE INDICES) AND INCREASED THEIR IMPORT QUANTITIES SUBSTANTIALLY, SERIOUSLY STRAINING THEIR RECEIVING AND DISTRIBUTING INFRASTRUCTURE. THIS HAS LED TO RAPID ESCALATION IN DEMURRAGE AND OTHER TRANSPORT CHARGES INCLUDING PREMIUM PAYMENTS FOR RAPID DELIVERY.

#### TREATMENT OF OPEC ASSETS

14. THE G-19 INSISTENCE ON PROTECTING REVENUE ACCUMULATIONS FROM OIL EXPORTS PERTAINS BOTH TO THE PURCHASING POWER OF SUCH REVENUES (PROTECTION FROM INFLATION AND EXCHANGE RATE CHANGES) AND TO PROTECTION AGAINST CONFISCATION OR IMPOUNDMENT OF THE ASSETS ACQUIRED WITH THESE REVENUES IN INDUSTRIAL COUNTRIES. THEY HAVE ALSO STRESSED THE NEED FOR FREER OPEC ACCESS TO INVESTMENT OPPORTUNITIES IN INDUSTRIALIZED COUNTRIES. ONLY A FEW OPEC COUNTRIES ARE ACTUALLY CONCERNED WITH THIS ISSUE, PRIMARILY SAUDI ARABIA. (NOTE: HOWEVER IMPORTANT IT IS TO THE SAUDIS, IT IS UNLIKELY THAT ANY POSSIBLE NORTH/SOUTH SPLIT AT THIS TIME OR IN DECEMBER WILL HINGE ON THIS ISSUE.) THE ECONOMIC AND POLITICAL RATIONALE PUT FORWARD BY THE G-19 FOR SPECIAL TREATMENT OF OPEC ASSETS IS THAT SUCH REVENUE SURPLUSES ARE UNIQUE AND DESERVE PROTECTION BECAUSE THEY DERIVE FROM THE PRODUCTION AND EXPORT OF A DEPLETABLE RESOURCE IN MAGNITUDES WHICH FAR EXCEED THE REVENUE NEEDS OF THE EXPORTING COUNTRIES IN ORDER TO PERMIT THE RATIONAL AND EFFECTIVE FUNCTIONING OF THE OIL-DEPENDENT INDUSTRIAL ECONOMIES.

15. WE ACCEPT ONLY THAT THESE SURPLUS OIL REVENUES ARE UNIQUE WITH RESPECT TO THEIR RAPID RATE OF ACCUMULATION; THEY ARE NOT UNIQUE IN ANY OTHER SENSE AND DO NOT WARRANT SPECIAL TREATMENT, AND PROVISIONS OF SPECIAL TREATMENT WOULD BE UNACCEPTABLE BECAUSE IT WOULD DISCRIMINATE AGAINST NON-OPEC INVESTORS AND DISTORT CAPITAL FLOWS. ALL COUNTRIES DEVOTE A

PORTION OF THEIR CURRENT INCOME TO INVESTMENT TO PROVIDE INCOME FOR FUTURE GENERATIONS. THIS PROCESS  
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TAKES MANY FORMS AND ASSUMES DIFFERENT PROPORTIONS ACCORDING TO THE COUNTRY INVOLVED. THE BASIC RATIONALE IS THE SAME: THE CAPITAL STOCKS OF DIFFERENT COUNTRIES -- WHETHER OIL IN THE GROUND OR PLANT AND EQUIPMENT -- ARE DEPLETED OR DEPRECIATED AS PRODUCTION OCCURS; IF PROVISION FOR REPLACEMENT IS NOT MADE, REAL INCOME WILL FALL IN THE FUTURE. INVESTMENT CAN TAKE PLACE DOMESTICALLY OR IN EXTERNAL ASSETS. THE INDUSTRIAL COUNTRIES INVEST ONLY A SMALL PART OF THEIR ANNUAL INCOME IN EXTERNAL ASSETS BUT OVER THE YEARS HAVE ALSO BUILT UP A LARGE ACCUMULATION OF EXTERNAL ASSETS. THE OIL EXPORTERS HAVE EXPERIENCED AN ALMOST UNPRECEDENTED GROWTH IN REVENUES OVER THE PAST 2 1/2 YEARS, AND THESE CANNOT BE PRODUCTIVELY EMPLOYED DOMESTICALLY AS YET, SO THESE REVENUES HAVE BEEN

INVESTED ABROAD.

16. WE BELIEVE THAT PROVISION OF SPECIAL PROTECTION AGAINST EXCHANGE RATE FLUCTUATION IS NOT WARRANTED. FOREIGN INVESTMENTS BY OPEC COUNTRIES WITH SURPLUS REVENUES ARE REALLY LONG TERM IN NATURE, EVEN THOUGH MANY ARE HELD IN SHORT TERM FORMS. ANY ANALYSIS OF THEIR PURCHASING POWER SHOULD NOT FOCUS ON SHORT TERM, TEMPORARY CURRENCY FLUCTUATIONS OR INFLATIONARY PERIODS. DURING PERIODS OF WEAKNESS, MOST CURRENCIES GENERALLY PROVIDE HIGHER YIELDING ASSETS. MOREOVER, ALL CURRENCIES CANNOT DEPRECIATE TOGETHER, SO IN A PROPERLY MANAGED ASSET PORTFOLIO, GAINS AND LOSSES SHOULD TEND TO BALANCE.

17. THE US AND OTHER G-8 MEMBERS ARE ALSO FIRMLY OPPOSED TO THE INDEXATION OF OPEC ASSETS. SCHEMES WHICH WOULD PROVIDE PROTECTION AGAINST INFLATION FOR ANY ONE GROUP OF INVESTORS WOULD BE COMPLEX, WOULD DISTORT CAPITAL FLOWS, AND WOULD BE INHERENTLY DISCRIMINATORY. IN FACT, A SCHEME FAVORING OPEC INVESTORS ALONE WOULD DISCRIMINATE AGAINST DOMESTIC INVESTORS, AS WELL AS OTHER FOREIGN INVESTORS. OPEC INVESTORS CAN OBTAIN SOME PROTECTION FROM INFLATION BY DIVERSIFICATION INTO REAL ASSETS INCLUDING EQUITIES, BUT ON BALANCE THERE IS NO SECOND BEST  
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SOLUTION TO THAT OF CONTROLLING AND REDUCING WORLD INFLATION, AND ALL COUNTRIES SHARE THE RESPONSIBILITY FOR THAT TASK.

18. WITH RESPECT TO THE ACCESS OF OPEC TO INVESTMENT OPPORTUNITIES, THE US DOES NOT APPEAR TO BE THE MAJOR TARGET OF G-19 DEMANDS. WE HAVE ALWAYS ATTACHED GREAT IMPORTANCE TO AN UNIMPEDED INTERNATIONAL FLOW OF CAPITAL. WITH FEW EXCEPTIONS THE US WELCOMES FOREIGN CAPITAL AND HAS GENERALLY CREATED NO OBSTACLES TO ITS ENTRY. WE HAVE MAINTAINED AN OPEN DOOR TO FOREIGN INVESTMENT AND ACCORDED "NATIONAL TREATMENT" TO FOREIGN INVESTORS. (THERE ARE SOME RESTRICTIONS AGAINST FOREIGN INVESTMENT IN KEY INDUSTRIES SUCH AS DEFENSE, SHIPPING, DOMESTIC AVIATION, COMMUNICATIONS, FIS;ING, AND ATOMIC ENERGY BUT THESE APPLY TO ALL COUNTRIES ON NON-DISCRIMINATORY BASIS).

19. WITH RESPECT TO POLITICAL RISK, THE G-8 COUNTRIES PROVIDE A STABLE ENVIRONMENT FOR INVESTMENT AND POLICIES THAT TREAT ALL INVESTORS EQUALLY AND FAIRLY. OUR RECORD ON NATIONALIZATION AND EXPROPRIATION IS VERY GOOD. BUT THERE IS A FEAR ON THE PART OF SOME OPEC INVESTORS OF POSSIBLE POLITICAL ACTION AGAINST



THEIR INVESTMENTS. WE BELIEVE THE BEST APPROACH TO THE PROBLEM OF POLITICAL RISK FACING INTERNATIONAL INVESTORS IS THROUGH MUTUAL RECOGNITION OF RECIPROCAL RESPONSIBILITIES AND NORMS OF BEHAVIOR. OUR SERIES OF BILATERAL FCN TREATIES AND THE MULTILATERAL UNDERSTANDINGS OF THE OECD HAVE HELPED ACHIEVE SUBSTANTIAL REDUCTIONS IN THIS RISK. IN RESPONSE TO THE G-19 REQUEST FOR PROTECTION AGAINST POLITICAL RISKS OF ANY OPEC INVESTMENTS, WE HAVE SUGGESTED WITHIN CIEC A MULTILATERAL AGREEMENT, PERHAPS IN THE FORM OF A CONVENTION, WITH RECIPROCAL OBLIGATIONS FOR THE PROTECTION OF FOREIGN INVESTMENTS IN AND BY THE PARTICIPATING COUNTRIES. THIS SHOULD INCLUDE OIL EXPORTING COUNTRIES, THE INDUSTRIAL COUNTRIES AND THE NON-OIL DEVELOPING COUNTRIES. THIS PROPOSAL WOULD BROADEN THE APPROACH TO POLITICAL RISK TO INCLUDE INVESTORS IN DEVELOPING COUNTRIES.

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20. WE CONSIDER THE ECONOMIC IMPLICATIONS OF INDEXATION OF COMMODITY PRICES OR OF OPEC FINANCIAL ASSETS AS SUFFICIENT REASON FOR OUR POSITION AGAINST THE CONCEPT. BUT EVEN IF IT WERE AN ACCEPTABLE IDEA THERE ARE A NUMBER OF TECHNICAL PROBLEMS RELATING TO INDEXATION OF COMMODITY PRICES AND FINANCIAL ASSETS, WHICH MIGHT BE AMENDABLE TO RESOLUTION ON A TECHNICAL LEVEL, BUT WOULD PROVE VERY CONTENTIOUS POLITICALLY IN ANY EFFORT TO REACH AGREEMENT ON AN INDEXATION SYSTEM. THESE INCLUDE:

- LACK OF SUFFICIENT AND ACCURATE DATA IN LDC'S.
- SELECTION OF A BASE YEAR FOR INDEX
- LENGTH OF TIME SERIES
- AGGREGATION OF INDEX
- PRESENT USE OF UNIT VALUE INDICES TO MEASURE IMPORT AND EXPORT PRICE TRENDS IN MOST COUNTRIES AS PROXIES FOR INDICES BASED ON ACTUAL TRANSACTION PRICE. UNIT VALUE INDICES ARE MEASUREMENT OF THE VALUE OF EXPORTS OR IMPORTS DIVIDED BY THE QUANTITY IN UNITS. AS SUCH THEY DO NOT REFLECT CHANGES IN THE QUALITY OF GOODS, AND ARE GENERALLY CONSIDERED TO HAVE AN UPWARD BIAS. KISSINGER

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